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Article 9 of the Uniform Commercial Code appears to be more revolutionary than the other articles of the Code because it is a new uniform act instead of a modernization of older uniform acts, as is the case for most of the other articles. However, Article 9 contains little innovation. When I had the pleasure of delivering lectures on the Code in the first two states to enact it, Pennsylvania and Massachusetts, I was able to say that the Code simply represented the modernization and the rationalization of certain statutes which were a fragmentary codification of the law of chattel security, namely, the Uniform Conditional Sales Act, the Uniform Trust Receipts Act, factors' lien laws, and statutes governing the perfection of assignments of accounts receivable. Both Massachusetts and Pennsylvania had laws in all of those fields, and the Code simply represented an attempt to combine all the forms of chattel security legislation into a rational picture.

In Kentucky it is still true that the Code deals with forms of chattel security which are perfectly familiar to every American lawyer. This Code is not the introduction of Roman law nor the law of a strange planet. Nothing in it will be unfamiliar to Kentucky lawyers once they master the terminology. It is a fact, however, that Kentucky has been behind most American jurisdictions in fragmentary codification of the newly developed law of chattel security. It has had no adequate treatment of conditional sales, except to subject them generally to chattel mortgage law. It has not had a trust receipt statute or a factors' lien statute or an accounts receivable statute. Therefore, for Ken-

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tucky it may truly be said that in the field of chattel security, the Code represents one giant step into the twentieth century.

To express the foregoing in somewhat more detail, it is useful to stop and make articulate some of the consequences of facts which everyone knows; namely, that prior to the growth of assembly line production of automobiles there were few types of wealth embodied in tangible personal property. Apart from livestock and an occasional piano or set of books, there are almost no nineteenth century cases on the law of tangible personal property. It is only in this century that wealth and our higher standard of living have found expression in the automobile; household chattels such as the refrigerator and the washing machine; machinery for mass production; equipment for service stations, supermarkets and the like; and equipment for service establishments like beauty parlors, tailor shops and laundries.

All of these types of chattel represent the embodiment of long-term use values. They are "big ticket items." They require a single decision to expend a large amount of money for satisfactions that will come back over a period of years. In order that mass distribution of them could be possible, it was necessary to find business mechanisms under which payment could be geared to a time schedule somewhat paralleling the enjoyment of the use values. The answer, of course, was the installment sale or installment loan. For this kind of business problem, the legal mechanisms of the nineteenth century were quite inadequate.

Nineteenth-century chattel law was essentially chattel mortgage law, which paralleled the static and rigid conceptions applicable to real estate mortgage law. Kentucky was actually somewhat behind other states in creating a modern chattel mortgage law, and obtained it only in the 1930's in connection with the push of the federal farm lending agencies to obtain state laws that would give them adequate security.[1]

There remained, however, vast areas of modern chattel transactions for which Kentucky had provided no statutory framework. The most obvious example is the retail installment sale of automobiles or other chattels on credit, with title retained by the seller or his assignee until payment. This key problem

[1] Ky. Rev. Stat. §§ 382.600-.730(1959) (hereinafter cited as KRS).

of modern distribution resulted in the drafting by the Commissioners on Uniform State Laws of a Uniform Conditional Sales Act[2] which was adopted in about ten states, and comparable legislation in numerous other states. As a generalization, conditional sales statutes require less in the way of formalities, such as witnessing, acknowledgements, and affidavits, than do chattel mortgage laws. In many states the conditional sale originally did not have to be filed, although more recent statutes have moved away from that kind of thinking in recognition of the fact that title retention created hazards for creditors and subsequent purchasers exactly comparable to the situation under chattel mortgages. There was also a general tendency toward shortening and simplification of conditional-sale documents, as compared to the traditional form of chattel mortgages. Kentucky, however, never adopted a comprehensive statute for conditional sales and they remained subject generally to the law applicable to chattel mortgages.[3]

As installment selling grew in importance, and banks and other institutions came to purchase the contracts from sellers, many states enacted retail installment selling acts to control the time price differential charged for the credit extension; to require disclosures as to these charges and insurance charges in connection with the transaction; and to regulate other aspects of the transaction such as extension, rewrites and prepayments. This tendency has received some recognition in Kentucky in the passage of a Motor Vehicle Retail Installment Sales Act,[3a] although the Kentucky statute does not go as far as some. It omits licensing of finance companies and does not apply to goods other than motor vehicles.

Similarly, a demand arose for certificate-of-title laws for automobiles, which would both help in controlling the theft problem and also serve as the device for filing and recording transfers of title or liens or both. The automobile is a special kind of chattel which is very mobile and thousands of cars fall into very few types, so that there are hundreds of cars that would appear identical except for serial numbers. The need for this kind of spec-

[2] 2 Uniform Laws Annotated.
[3] See Munz v. National Bond & Investment Co., 243 Ky. 293, 47 S.W.2d 1055 (1932); GMAC v. Sharp Motor Sales Co., 233 Ky. 240, 25 S.W.2d 405 (1930).
[3a] KRS §§ 190.090-.140.

ialized legislation was again felt late in Kentucky. Finally, in 1958 it led to the passage of an act in Kentucky which was not modelled after the Uniform Motor Vehicle Certificate of Title and Anti-Theft Act[4] recently promulgated by the Commissioners on Uniform State Laws nor on any of the thirty-odd state laws already existing. It is a statute of fragmentary nature unintegrated with the Code, which leaves more problems unsolved than it solves. Some of these will be discussed below.

Prior to the sale of automobiles, refrigerators, or industrial equipment to a consumer or other user, the dealer or distributor must acquire them from a factory and have them available on his floor or warehouse. In the hard-goods field, particularly consumer goods, factories have established a pattern of extending no credit and requiring payment upon shipment. This throws upon the dealer the burden of paying cash. As prices rise and styles and models proliferate, the cash required to carry such inventories becomes unavailable without secured financing. The chattel mortgage is essentially unsuitable as a vehicle for this financing, both because it provides no mechanism for avoiding repetitious preparation of lengthy documents and repetitious recording thereof as the inventory rapidly shifts, and also because the nineteenth century had developed rules of law casting grave doubt on the validity of chattel mortgages on inventory.[5]

A practice developed of handling this kind of inventory financing by a device borrowed from the practices of import trade; namely, the trust receipt, the theory of which is that the financial institution pays for the merchandise, takes title and entrusts the merchandise to the dealer. After this device had been extensively borrowed for use in the financing of inventories of automobiles and similar products, the Commissioners on Uniform State Laws codified the practice into the Uniform Trust Receipts Act[6] which is in force in over thirty states, but again the development passed Kentucky by.

Another development was the need for a financing mechanism for inventories of a different nature—not large discrete

[4] Uniform Motor Vehicle Certificate of Title and Anti-Theft Act, 9B Uniform Laws Ann. 239.

[5] See Sandy Valley Grocery Co. v. Patrick, 276 Ky. 768, 103 S.W.2d 307 (1937); Cohen & Gerber, "Mortgages of Merchandise," 39 Colum. L. Rev. 1338 (1939).

[6] 9-C Uniform Laws Ann. 231.

units like automobiles, but inventories of raw materials and parts going into a manufacturing process as in the textile and machinery trades. Here the required mechanism was one by which an aggregate inventory, shifting in its components and also being transformed, could remain subject to a lien throughout the process of fabrication. For this purpose, as the result of a long history, there was developed a form of factors' lien which, without the sponsorship of the Commissioners on Uniform State Laws, met such a demand that it has been enacted in the post-war period in over twenty states.[7] Again this was a development that by-passed Kentucky. Another development was the growth of financing to relieve manufacturers and distributors from pressure on their working capital, arising from the trade credit represented by their accounts receivable. Extensive practices of accounts-receivable financing developed, but their legal status was put in jeopardy and rendered uncertain by decisions as to the necessity for "notification" to the debtor that his account had been assigned.[8] These legal doubts were put at rest in over thirty states by the enactment of accounts receivable statutes, some of which validated the assignment without notification to the debtor or other action, and others of which required central filing of notice to the effect that the creditor was assigning his receivables to a named financial institution. However, Kentucky did not join in the adoption of such statutes.

It is wholly understandable that when Kentucky was primarily an agricultural state, the pressures for modernization of commercial law should have been less forceful than they were in other states. It is reasonable to hazard the guess that with the new river power developments and other foreshadowings of industrial development in Kentucky, the demand for modernization of Kentucky's chattel security law would have grown rapidly had not the legislature wisely forestalled the demand by enacting the Uniform Commercial Code.

Article 9 of the Code[9] is essentially a rationalization of the

[7] See Fechteler, "The Factor's Lien Statutes," 11 Bus. Law. 60 (1956); and list of the statutes *id.* at 70.

[8] Corn Exchange National Bank & Trust Co. v. Klauder, 318 U.S. 434 (1943).

[9] The Code as passed in Kentucky is Ky. Acts 1958, ch. 77, Legislative Research Commission, Informational Bulletin No. 24 (1959). It is based on the 1957 Official Text of the Code as published by the American Law Institute and the National Conference of Commissioners on Uniform State Laws. References herein to "UCC § " are to the Kentucky Code and the 1957 Official Text,

statutory development just reviewed, and the elimination of accidental and historical discrepancies as to the coverage and scope of the several devices mentioned. Article 9 starts with the financing of inventory; proceeds through sale or creation of a "security interest" or lien on the goods in connection with a retail sale or by a separate transaction in loan and "chattel mortgage" form; and also covers the disposition of the resulting accounts receivable or installment receivables in financing transactions. Article 9 thus has in itself the same unity as underlies the Uniform Commercial Code as a whole; namely, the sale of goods as the prime commercial transaction, together with the credit instruments which are created in the processes of sale and of distribution before and after sale.

Article 9 has a somewhat unfamiliar terminology. It uses the term "security interest" instead of conditional sale contract, chattel mortgage, lien, trust receipt, or other such name. It uses the term "secured party" instead of chattel mortgagee, conditional vendor, entruster, etc. It uses the term "debtor" instead of mortgagor, conditional vendee, trustee, etc. This new terminology is for the purpose of getting away from the connotations attached to these older terms under the former separate devices, thereby emphasizing the essential unity of chattel security devices as conceived under the Code without regard to mechanism. Once the terminology is grasped, Kentucky lawyers will have no difficulty working with the concepts of the Code, because they are essentially the familiar concepts of the law of security, with changes in scope and application.

As we review the five parts into which Article 9 is divided, it will be apparent that Article 9 is broadening and amendatory, rather than revolutionary.

DEFINITIONS

Part 1 is essentially a matter of definitions. It is unfortunate that these definitions serve as the introduction to Article 9, because they seem to be complex and difficult. In fact, they are of relatively little importance and the best thing to do is forget

unless otherwise indicated. Occasional reference will also be made to the 1958 Official Text, which contains some corrections, and the 1954 Official Text, which was the first form of the Code and was adopted in Pennsylvania.

about them unless and until someone has occasion to study a definition in a context in which it might be material. For instance, the term "inventory" is defined, but never used in the substantive parts of Article 9. The distinctions between "inventory" and "equipment" and "consumer goods," have some significance for filing purposes in the provisions of the Code as drafted by the Commissioners on Uniform State Laws.[10] Since Kentucky adopted a single uniform principle of local filing,[11] these distinctions are of no importance in Kentucky for that purpose. They retain only a very slight importance in the application of the default provisions.[12] The distinction between "account receivable" and "contract right"[13] is particularly unfortunate, since the two types of rights are treated identically except for a single provision,[14] where a distinction could have been drawn without this complex nomenclature.

Another regrettable piece of definition is the terrifying and abstruse concept of attachment.[14a] All it means is the point at which a security interest becomes good between the parties. So expressed, the elements of the term are self-evident. A security interest is good between parties when there are (1) an agreement, (2) consideration, and (3) a property interest that can be subjected to the lien. Yet the definition makes the obvious concept look very difficult.

CREATION OF THE SECURITY INTEREST

Part 2 of Article 9 deals with the creation of the security interest. All formalities are eliminated, except that there must be a written agreement, unless the security interest is created by pledge or delivery of possession. The Code has no rules of law based on the question when title passes, and all rules are stated without regard to that question. This is not to say that the parties cannot draw an agreement for non-Code purposes making a distinction as to when title passes. If there is a local or federal tax

[10] UCC, 1957 Official Text, § 9-401.
[11] UCC § 9-401.
[12] UCC § 9-505.
[13] UCC § 9-106.
[14] UCC § 9-318(2).
[14a] UCC § 9-204(1). Subsection 9-204(2) has some formidable special rules for attachment of security interests in crops, fish, minerals, timber, accounts and contract rights, but no one has yet suggested any likely case where these rules would govern a problem.

consideration or other non-Code consideration affected by the passage of title, the distinction can still be drawn. As far as the Code is concerned, however, conditional sale contracts (in which title does not pass) and chattel mortgages (in which title is assumed to pass) are treated identically.

This leaves the drafting of forms for standard instruments completely flexible. Every lawyer has the problems of borderline cities like Cincinnati and Louisville which serve interstate areas, and national companies have nationwide problems. Lawyers find it perfectly feasible to use the same form for both a Code state and a non-Code state like Ohio which uses principally chattel mortgages, or both a Code state and a non-Code state like Tennessee which uses principally conditional sale contracts. Any form that works well under pre-existing law in any state will work equally well under the Code. This discussion is just as accurate as applied to motor vehicles, which are subject to the Kentucky Motor Vehicle Retail Instalment Sales Act, as it is to other types of goods where the legal requirements as to form are governed exclusively by the Code. For this reason the contentions that have been made to the effect that rewriting of forms under the Code is expensive are wholly without foundation.

Part 2 also contains provisions granting the utmost flexibility as to the inclusion of future-advance clauses in the statement of the amount secured by a security agreement, whether or not there is a commitment to make future advances,[15] and as to the inclusion of after-acquired property under the security agreement.[16] This contrasts with former Kentucky law, which covered after-acquired property only under provisions which referred to "tools, machinery or farm implements . . . which may be thereafter acquired" and to replacements of any of the mortgaged property.[17] The former Kentucky law likewise limited future advances to those to be made within one year and not to exceed an aggregate amount stated in the mortgage.[18] The breadth of the Code provisions may seem alarming, but in themselves they occasion very little difficulty. They simply avoid the necessity for supplemental mortgages, pursuant to agreement in the original mort-

[15] UCC § 9-204(5).
[16] UCC § 9-204(3). Minor exceptions appear in § 9-204(4).
[17] KRS § 382.610(2)(c) and (3).
[18] KRS § 382.620.

gage, and avoid extensive title searching as preludes to subsequent advances. They accomplish mechanical facility rather than any innovation in the kind of financing that is possible. As will be pointed out below,[19] the priorities problems of the Code stem not from these broad after-acquired property and future advance provisions, but from notice filing.

The Code also contains a provision[20] eliminating the rule of *Benedict v. Ratner*;[21] that is, the rule which required a mortgagee of inventory or assignee of accounts receivable to exercise "dominion" over the proceeds as his security was transformed into cash by the sale of inventory or collection of receivables.[22] This rule had been recognized as to inventory in Kentucky.[23] The abolition of the rule makes theoretically and practically possible an effective security interest in a changing stock of inventory like that of a department store. There are persons who have argued that this provision abolishing the "dominion" rule plus the broad future-advances and after-acquired property provisions make possible a "floating lien" of which they are fearful. The fears are not unreasonable, but experience to date in Pennsylvania and Massachusetts has not indicated any pre-emption of all of a debtor's potential collateral either to his detriment or to that of his trade creditors.[24]

PERFECTION OF THE SECURITY INTEREST

Part 3 of Article 9 deals with the perfection of security interests and Part 4 deals with the most important method of perfection, namely, filing. The structure of Article 9 as to perfection of security interests, a relatively new term in the law of property, is as follows:

(a) A security interest in types of personal property which

[19] See pp. 384-85 *infra*.
[20] UCC § 9-205.
[21] 268 U.S. 353 (1925).
[22] See Cohen and Gerber, "Mortgages of Accounts Receivable," 29 Geo. L.J. 555 (1941); Cohen and Gerber, "Mortgages of Merchandise," 39 Colum. L. Rev. 1338 (1939).
[23] Sandy Valley Grocery Co. v. Patrick, 276 Ky. 768, 103 S.W.2d 307 (1937).
[24] Another part of the floating lien fear rests on UCC § 9-108, which provides that security acquired under an after-acquired property clause in the ordinary course of business shall be deemed taken for new value and not as security for an antecedent debt. This aspect of the floating lien problem is far less important than the provisions of the Code mentioned in the text. Indeed, it may be questioned whether any state declaration can change the bankruptcy standard of preference.

are physically capable of delivery of possession may be perfected by pledge (delivery of possession) without filing. The types of personal property which can be pledged include all "goods" or tangible chattels; instruments (that is, negotiable instruments and securities); negotiable documents of title; and chattel paper (that is, conditional sale contracts, chattel mortgages, and the like).[25]

(b) Subject to the exceptions to be mentioned in (c) and (d) below, perfection of all other security interests requires filing. This means that, except as stated in (c) and (d), all liens in the nature of chattel mortgages, conditional sales, and trust receipts must be filed. Security interests may not be perfected by pledging a non-negotiable document of title, but, of course, the issuance of the non-negotiable document of title in favor of a creditor amounts, in effect, to a pledge of the goods to him, and the warehouse man or carrier is bailee on his behalf.[26] A security interest in chattel paper may be perfected either by filing or by delivery of possession without filing,[27] but if delivery of the paper is not taken, any bona fide purchaser of the paper for new value who takes possession of it in the ordinary course of business and without knowledge of the pre-existing security interest has priority over the security interest perfected without filing.[28]

This last set of provisions is of particular interest. As transactions in automobiles and other consumer goods have multiplied, billions of dollars of credit instruments (chattel paper) flow into the channels of commerce every year. In most cases when the dealer sells chattel paper to a financial institution, he delivers the paper. It has always been thought that the paper was a specialty, an indispensable instrument, and that passage of title to the paper or a lien thereon was completed by the delivery of the paper. Yet there are certain forms of financing for which delivery of the paper is not convenient. In the ordinary furniture store or department-store appliance department, the contract is a very short form written on the back of a ledger card. The store believes that it cannot physically deliver the contract. And yet

25 UCC § 9-305.
26 *Ibid.*
27 UCC §§ 9-304(1), 9-305.
28 UCC § 9-308.

the bank wants good security. That means that some form of non-possessory arrangement for assignment of those contracts is needed. Prior to the Code this simply was an insoluble problem. The Code solves it, because under the Code the assignment of chattel paper can be perfected by filing without delivery, if the bank is willing to take the risk of fraudulent delivery of the paper to another assignee.

(c) There are certain special exceptions permitting perfection without filing for temporary periods.[29] These were deemed necessary to facilitate import transactions and the exchange of documents for goods in documentary draft transactions, such as the transmission of bills of lading or warehouse receipts through banking channels accompanied by drafts. These very specialized provisions may be disregarded by the average lawyer.

(d) In recognition of the fact that in most trading areas it has not been customary to file or record conditional sales contracts or chattel mortgages in small amounts on consumer goods, there are provisions that filing is not necessary to perfect purchase-money security interests in consumer goods other than fixtures and motor vehicles, and in farm equipment having a purchase price not in excess of $2,500.[30] This means that the unfiled security interests will be good against creditors or in bankruptcy. There remains the possibility that a consumer whose ownership was subject to a security interest because he had purchased on time might fraudulently sell to another consumer. The Code provides that if such other consumer buys without knowledge of the security interest, he takes free of it unless a financing statement has been filed covering the security interest.[31] It will remain for each creditor to appraise this latter risk and determine whether in practice he will file the small consumer items. It can well be argued that this is not a satisfactory rule of law from the point of view of the second consumer, but there was a problem of conflicting interests, and it was impossible to reach a compromise solution that was satisfactory to everyone.

Motor vehicles present a special problem. The Code had to be drafted with alternatives in recognition of the fact that some states have, and some states do not have, certificate-of-title laws

[29] UCC § 9-304(4) & (5).
[30] UCC § 9-302(c) & (d).
[31] UCC § 9-307(2).

controlling the title to, and the creation of liens on, motor vehicles. At the time the Code was adopted in Kentucky, Kentucky did not have such a statute, but Kentucky adopted a statute during that session of the legislature.[32]

The statute is not in the typical form of certificate-of-title statutes. It calls, in effect, for a double form of public notice, once by showing the lien on the registration receipt for the car and the copy thereof in the Recorder's office, and secondly, pursuant to a 1960 amendment, by standard filing under the Code. It is not integrated with the Code. In this writer's opinion, it is not a full certificate-of-title statute and does not obviate the necessity for normal filing under the Code.

The writer would recommend that either Kentucky adopt a full certificate-of-title statute that would replace the normal filing under the Code, or eliminate the requirement that the lien be noted on the registration receipt and the copy thereof. There is no excuse for double requirements for public notice.

Inventory presents a special problem. The Code makes possible a security interest on inventory, but, of course, it is expected that inventory will be sold. The wheels of commerce would stop if the purchaser of an automobile or a refrigerator in a showroom had to check the records to see whether the dealer's stock was subject to an inventory lien, and then make sure that the lien was paid off before he purchased. Accordingly, even though the security interest is perfected by filing, a buyer in the ordinary course of business takes free of a security interest in inventory.[33]

Once security interests in inventory and accounts receivable were validated, special problems had to be faced as to the transfer of the security interest to the proceeds when the inventory is sold or the accounts receivable are collected. The Code is the first property statute which attempts to deal comprehensively with that subject.[34] While it would be wrong to say that the Code solves all problems thereunder, it certainly advances the solution beyond any pre-existing state of the law. Some of the problems involved will be discussed below.

Similarly, while the Code cannot solve the perennially troublesome problem as to what is a fixture, it does deal in modern

[32] Ky. Acts 1958, ch. 82.
[33] UCC § 9-307(1).
[34] Compare Uniform Trust Receipts Act, §§ 9 and 10.

fashion with the difficult problem as to the affixation of chattels such as furnaces, air-conditioning, etc., to real property, and the resulting clash between persons holding security interests in the chattels and persons claiming to be the real estate owners or mortgagees.[35] In general, the Code adopts the principle that a chattel security interest which existed before affixation remains valid (subject to perfection by filing, of course) and that the chattel can be removed by the secured party subject only to making good any damage to the real property.

For Kentucky lawyers the rules of Article 9 governing filing, in part 4, will be surprising, because Kentucky has had no prior experience with notice filing. The Factors' Lien Acts and the Uniform Trust Receipts Act, both of which apply to inventory situations, recognized the impracticability of recording or filing every transaction involving the financing of inventory, because shipments of inventory might be received weekly or even daily. Accordingly, they provided, in substance, for a single filing of notice that inventory financing transactions would take place, without specifying the amount and without attempting a detailed description of a changing stock of inventory. For similar reasons, the statutes as to notice of accounts receivable financing also provided for central notice filing. The draftsmen of the Code adopted this notice filing not only for recurring types of financing such as inventory and accounts receivable, but also for transactions which are not likely to recur regularly between the same parties, such as an individual conditional sale contract, a chattel mortgage executed when an automobile or other vehicle was purchased on time or an individual chattel mortgage loan.

It should be emphasized that the original security interest (chattel mortgage or conditional sale) need not be filed; instead, one may file a simple notice giving bare elements: the names and addresses of the parties and the general nature of the collateral. On February 15, 1960, the Kentucky General Assembly passed House Bill No. 73, which requires the financing statement for consumer goods only to show serial numbers, if any, and for automobiles and motor trucks to contain in addition the make, year, model and motor number. While this makes the Code non-uniform, as will appear below the writer cannot disagree

[35] UCC § 9-313.

with the wisdom of this in the case of individual, non-recurring financings. Incidentally, one might question whether the legislature intended to exclude from the operation of the statute passenger automobiles, such as salesmen's and doctors' cars, which are not strictly speaking "consumer goods."

When the draftsmen o fthe Code proposed to adapt notice filing to individual transactions such as sale of an automobile on time or a bank loan to a small factory on the security of its machinery, the writer raised the question whether that was a sound extension, but was overruled. The experience in Pennsylvania, which now has had the Code in operation for five full years, has not borne out these original fears. There have not been in practice any of the serious conflicts which this notice filing makes possible. Perhaps a large part of the reason that the practice has proved better than the threat has been that many people have not chosen to use the full freedom of action that the Code has given them. They have chosen to file the security agreement, rather than a simple notice, and they have thereby avoided the possibility that a broad notice would create confusion.

Let us explore, however, the basis of these fears. The form of filing is very simple and a suggested form is set forth in the Code.[36] It merely gives the names and addresses of the parties and describes the type of property involved. Thus it would appear that if an individual bought a Ford automobile from a dealer, a financing statement would be good which described the property involved as "automobiles" without referring either to the make, the year, the model, or the serial number. This could theoretically create problems, because even though the individual had only contemplated a single purchase, a subsequent purchase between the same parties during the life of the original financing statement (up to five years) would be covered by the same financing statement. Someone else might have a financing statement also covering automobiles, either alone or in connection with other goods. To solve resulting possibilities of conflict, the Code has a section on conflicting security interests.[37] Its basic rule is that if two security interests were both perfected by filing, the first to file has priority; but in other cases (*e.g.*, when one was perfected by pledge) the first to perfect

[36] UCC § 9-402.
[37] UCC § 9-312.

has priority. The resulting problems have been explored in a detailed article.[38] It will be sufficient to suggest them with one example: Suppose that Bank *A* lends some money to a contractor on the security of a power shovel, but their financing statement describes the property covered as "road-building equipment." Later, Bank *B* lends some money to the same contractor on the security of a tractor and files a financing statement describing the tractor in detail.

Still later, Bank *A* wants to take a "second mortgage" on the tractor as further security for its original loan. Both banks then find to their surprise that since Bank *A* was the first to file, and its financing statement covered "road-building equipment," Bank *A*'s security interest in the tractor comes ahead of the security interest of Bank *B* which was earlier in time.

It will be seen that this problem has nothing to do with after-acquired property clauses or with future-advance clauses, but arises solely out of the breadth of notice filing.[39] Bank *A*'s claim to the tractor might possibly arise under an after-acquired property clause without a new security agreement; but even if it arose under a new security agreement, it is the priority granted to the first filing which produces this unexpected result.

Now in the hypothetical case mentioned, the writer was careful to state that both banks were *lending* money—that is, the possibility was excluded that the interest of either bank was a "purchase money security interest,"[40] because the Code largely mitigates the consequences of a first-to-file rule with an exception in favor of purchase money security interests.[41] This was necessary in order to make possible the transaction of ordinary installment sales business by dealers with purchasers, without the dealer having to search the record to make sure that the purchaser did not have a prior filing broad enough to cover the kind of equipment involved.

Unfortunately, section 9-312(4) as drawn in the 1957 Official

[38] Coogan, "Article 9 of the Uniform Commercial Code: Priorities Among Secured Creditors and the 'Floating Lien'," 72 Harv. L. Rev. 838 (1959).

[39] In the 1954 Code as adopted in Pennsylvania, this point was inadequately realized, and the exceptions for purchase-money interests were therefore wrongly phrased. 1954 Official Text, § 9-312(3) and (4).

[40] Defined in UCC § 9-107 to include a person whose money is used to pay a seller, as well as a seller (and his assignee).

[41] UCC § 9-312(3) and (4). In the case of inventory, the person doing the purchase-money financing must also give notice of that fact to the person with the prior filing, before the debtor receives possession of the collateral.

Text and adopted in Kentucky is defective. It requires perfection of the purchase money security interest before delivery of possession to the equipment. We are talking about the purchase of an automobile or a piece of equipment from a dealer. It could happen on a Saturday or Sunday; it could happen after hours; or after the County Clerk's office closes on a weekday. It is simply an impossibility to hold up the delivery of a truck or other piece of equipment that a purchaser wants, until one can get notice on file in the local County Clerk's office. The dealer won't wait for it; the purchaser won't wait for it. So, in requiring perfection before delivery of possession, section 9-312(4) as enacted in Kentucky contains an error of great importance. This point was discovered when procedures were being developed for operating under the Code in Massachusetts. The American Law Institute and the Commissioners recognized the error, and in the 1958 supplement to their recommended Code,[42] they corrected the error by changing section 9-312(4) to allow ten days after delivery of possession within which to perfect the purchase money security interest.[43] That correction is embodied in the law of Connecticut and New Hampshire which passed the Code in 1959 (effective 1960). Massachusetts and Pennsylvania have corrected it also. It is hoped that when Kentucky wrestles, as it must, with the problem of the relation of its automobile statute to the Code, it will also make the necessary change in section 9-312(4).

Did we create these problems of conflicts ourselves in drafting Article 9? The answer, it seems, is about half-and-half. Partially, the problems were created by the breadth of the provisions for after-acquired property, future advances, and notice filing. These provisions make possible conflicting security interests to an extent that was not heretofore possible. The other half of the story is that when the numerous forms of chattel security, including non-possessory forms (chattel mortgages, conditional sales and trust receipts), a possessory form (pledge), and drafts accompanied by bills of lading or warehouse receipts (which are fundamentally transactions in the goods represented by the documents), were pulled together and put side by side,

42 1958 Official Text, § 9-312(4).

43 The original Pennsylvania Code had allowed this ten days, which was omitted by some inadvertence in the 1957 revision.

it was realized that certain potentialities of conflict had always existed, but somehow had never been faced. They are not of too great importance. The mere fact that they never had to be faced shows that they are rare. Many of the problems covered by section 9-312(4) simply present themselves because for the first time the Code has gathered together all the numerous areas where chattel security could be created, and dealt with all the problems of conflict at once.

PLACE OF FILING

Some comment must now be made as to the place of filing. The notice-filing statutes which served as the models for the Code namely, the factors' lien acts, the Uniform Trust Receipts Act, and the accounts receivable statutes, all contemplate filing at a single place in the state, which is usually the Secretary of State's office. In the drafting of the Code, the draftsmen would have liked to follow this pattern, but met with opposition from lawyers from the less industrialized states who were more accustomed to local filing, less familiar with the statutes mentioned, and unwilling to communicate with the state capital for information as to existing filings. The Code is therefore drafted in alternative form to permit either central filing alone or a combination of central plus local filing.[44] In the two states which acted before Kentucky, namely, Pennsylvania and Massachusetts, the pressures from lawyers outside the big cities caused the legislatures to adopt the latter alternative, with the result that double filing is required in both states, except for consumers' goods where the Code contemplates only local filing. Now something can be said for local filing and something can be said for central filing, but certainly nothing can be said for double filing. In Kentucky, as a relatively little-industrialized state, it was obviously impossible to adopt central filing only, and therefore, the Kentucky legislature wisely adopted only local filing in a manner which conforms to past Kentucky experience.[45]

DEFAULT AND ENFORCEMENT

Part 5 deals with default and enforcement. Essentially, the Code tries to get away from sterile theory. The theory of the

44 1957 Official Text, § 9-401.
45 UCC § 9-401.

law has been that the way to protect a defaulting debtor is to have a public sale of his automobile or other collateral. Everybody knows in practice that public sales are usually perfunctory, and nobody bids but the creditor. Not only that, but there never would have been a sale if the debtor had any equity to protect; if he had had any equity, he would have sold the goods himself to salvage his equity, rather than go into default, or he would have found substitute financing.

The Code, therefore, tries to get away from the public sale as a theoretical protection of the debtor, and recognizes the practical fact that a public sale is almost invariably a waste of time. It provides that all enforcement remedies of the creditor must be "commercially reasonable." That phrase frightens some people, but it is a phrase that the courts will read into these transactions anyway.[46]

The Code permits the creditor to give the debtor notice that he does not intend to sell the property and will keep it in satisfaction of the debt. That is the end of the transaction unless the debtor comes back to him and says, "No, I think I have an equity. I want you to sell it." If the debtor so notifies, the creditor has to hold a sale in compliance with the statute.[47] The one exception is a special provision (requiring sale regardless of demand) in a purchase-money transaction involving consumer goods where the consumer has paid sixty per cent of the cash price.[48]

For the rest, the Code's enforcement provisions contain new language breaking out of old habits of thought, but there is little that should be unfamiliar or shocking to any American lawyer.

SOME PRACTICAL APPLICATIONS OF ARTICLE 9

This discussion will cover some of the same ground already touched upon, but will try to make operation of Article 9 concrete rather than a collection of abstract rules. It will indicate how Article 9 operates for the standard retailer, shifting from time to time for convenience from a furniture appliance dealer

[46] *Cf.* Commercial Credit Co. v. Cooper, 246 Ky. 513, 55 S.W.2d 381 (1933); In re Kiamie's Est., 309 N.Y. 325, 130 N.E.2d 745 (1955).
[47] UCC § 9-505(2).
[48] UCC § 9-505(1).

to an automobile dealer or to a department store, or at other times to a seller of road-building equipment.

The first problem again is inventory credit. Let us start with a retailer of appliances, such as refrigerators. Article 9 re-enacts inventory financing as it worked for new goods under the Uniform Trust Receipts Act. It contemplates a very simple notice saying, "I, the *X* bank, am going to do business with *Y* Appliance Company and finance refrigerators and other household appliances." That is the only filing. Under the Uniform Trust Receipts Act, it was good for a year. Under the Code, it is good for five years. Under that simple notice, there will occur week by week a series of transactions by which the retailer buys refrigerators and other "white goods" from the manufacturer, and the bank or other financial institution will pay for them, acquiring a chattel mortgage interest (as it has been called in Kentucky) or a security interest (as it is called under the Code) on the goods financed.

The individual trust receipts (or security agreements as they will be called under the Code) need not be filed. This is a great advantage, because the financing is continuous. Under the Uniform Trust Receipts Act, financial institutions found it inconvenient in modern, high-speed business operations to get the security agreements signed, especially where a bank in a city like Louisville financed a refrigerator dealer in a small town on weekly shipments. There was a considerable amount of experimenting under the Uniform Trust Receipts Act to avoid regular signing and delivery of trust receipts. One experiment was to permit the retailer to appoint an employee of the bank as his agent to sign the trust receipt for him.

Under the Code, it is perfectly clear that there need be no actual signature of individual trust receipts. Instead, a basic underlying agreement can provide that if the bank advances the money to pay for the refrigerators for the retailer, the bank shall have a security interest on each item paid for. If the bank feels uncomfortable without the dealer's signature to each individual security agreement, it may get individually signed security agreements. If it feels comfortable and is content to rely on the underlying agreement and the proof that it paid the manufacturer and that the dealer took the goods, then it need not be bothered with the paper work (the bane of all modern security transactions) of getting each trust receipt separately signed.

Refrigerators rather than automobiles were deliberately used in the foregoing example, because automobile financing is affected by Kentucky's new statute, effective January 1, 1960,[49] as to which there is considerable difficulty in interpretation. This statute, very briefly, provides that the registration receipt in the possession of the owner and the copy of the receipt in the County Clerk's office shall each have the liens recorded on it. It is something like a certificate-of-title law, but as the writer reads the statute, it is not a full certificate-of-title law. Section 11 of this statute added the following to Kentucky's chattel mortgage statute:

> No instrument conveying or reserving a security interest in a motor vehicle shall be recorded unless the vehicle has been properly registered.

What does that mean in the case of a new car in the dealer's showroom, which has never been registered because it has never been on the highway? It is hoped that since there is no duty to register that car until it is on the highway, section 11 does not apply and one can have a good security interest in it without having the car registered. If this is the correct interpretation, automobile floor-plan financing in Kentucky will work just as in the foregoing refrigerator example. But if one has to have a registration receipt on the car in order that a floor-plan lien can be shown, then the intent of the Code to have a simple one-time filing will have been frustrated.

A similar problem arises with demonstrator cars that the dealer has available to show prospective purchasers. The demonstrator ordinarily is not registered (if it is owned by the dealership and not by the salesman personally), and it operates with dealer license plates. It is hoped that the reasoning just suggested will apply equally to it.

The used automobile that the dealer has taken in trade is a much more difficult case. The Trust Receipts Act never worked for used cars because it contemplated purchase-money financing only. The purchase-money concept was built into the Trust Receipts Act to distinguish the trust receipt from the chattel

[49] Ky. Acts 1958, ch. 82.

mortgage. We are no longer making that distinction, so the simple notice filing for floor-plan financing will work just as well under the Code for a used piece of equipment as it will for new.

Where lien rules of automobile certificate-of-title laws are applicable to dealers' floor plan financing, they are never successfully reconciled in the statutes with the general rules for perfection of liens for floor-plan financing, and Kentucky is no exception. In the typical state, the certificate-of-title law provides that all liens must be shown on the certificate of title of a registered motor vehicle. But most statutes make provision in their motor vehicle registration laws that when a used car is traded in by the original owner to a dealer, the dealer need not get it registered in his own name. He can hold the old registration certificate endorsed in blank until he sells it to a second purchaser, and he then completes the endorsement with the new purchaser's name. It is understood that it is not uncommon for dealers to "jump the title" in that fashion in Kentucky, even without statutory authorization. But consider what this means in terms of floor-plan financing. The car is registered. The Kentucky statute says that the lien must be shown on the registration receipt and on the copy in the Clerk's office; but if the dealer has not obtained a registration receipt in his own name, it is obviously impossible and incongruous to show a lien against him on a receipt which is in somebody else's name. Moreover, if it is necessary to show each item of floor-plan financing on the registration receipt of an individual car, the purpose of the Code to create a streamlined financing mechanism with a one-time notice will have been frustrated.

One other point should be mentioned in connection with inventory financing. In financing of road-building equipment and similar industrial machinery, it is customary for the factories to grant trade credit for thirty to ninety days. The equipment manufacturers differ in that respect from the automobile and appliance manufacturers who demand spot cash. Therefore, in equipment floor-plan financing, the dealer may have carried his inventory for thirty to ninety days on trade credit extended by the manufacturer before he asks for floor-plan financing from someone else. The Trust Receipts Act never worked for that purpose because this was no longer financing contemporaneous with the purchase. Article 9 will work in this situation, because the purchase-money concept has been removed from the inventory financing mechanism.

The Code and its predecessor, the Trust Receipts Act, recognize the unique character of inventory as collateral, and create the concept of split perfection; *i.e.*, the perfection of a lien that is good against creditors (and therefore good against the trustee in bankruptcy) but not good against the bona fide retail purchaser. An inventory lien could not be good against retail purchasers or commerce would be impossible.[50] If the creditor loses his lien on inventory when it is sold, what happens to the lien? The dealer is expected to pay off the debt. What if he does not do so? The answer seems absurdly simple once it is stated: The lien on the inventory is transferred to the "proceeds" of the sale. It is much easier to say that than it is to work it out in detail. Three types of problems that rise under this concept of "proceeds" will be mentioned. The first is when the proceeds are in cash. Obviously, one cannot trace cash in fact, but there are rules for tracing with which we are all familiar. The draftsmen of the Code were very fearful of difficult tracing litigation. They tried to forestall such litigation by an arbitrary rule that the creditor was to have a preferred security interest in the cash that the dealer had on hand, equal to his collections for ten days immediately preceding insolvency, less whatever part of those ten-day collections he had already turned over.[51] This rough-and-ready rule seems to be a fair attempt to solve a difficult problem.

The next proceeds problem concerns the trade-in. Under Article 9, the floor-plan security interest in the original inventory transfers to the trade-in.[52] There should be no difficulty with this rule, because under the concept of notice filing, anyone is charged with the knowledge that the dealer may have any or all of his cars subject to a floor-plan lien. Anyone other than a retail purchaser must find out which inventory, new or traded-in, is subject to liens.

The third type of proceeds problem relates to receivables, either open accounts receivable or installment chattel mortgages

[50] UCC § 9-307(1).
[51] UCC § 9-306(4)(d).
[52] UCC § 9-306(2).

and conditional sales contracts, which are called "chattel paper" in the Code. Here the Code has two different rules. In both cases, the floor-plan lien attaches to the proceeds in substitution for the goods sold. In the case of open accounts receivable the proceeds lien (if covered by the filed notice) is good against anyone else.[53] In the case of chattel paper, the Code draftsmen made a deliberate choice of policy and provided that if someone else gets delivery of that chattel paper and pays for it, he acquires good title to it even though he knew that there was a proceeds claim to it.[54] The purpose of that rule was to prevent the inventory financier from pre-empting the opportunity to buy the chattel paper, which is considered a very desirable article of commerce. There is enough distinction between accounts receivable and chattel paper, as a practical matter, to justify this difference in legal rule. It is all but impossible to finance inventories and resulting open accounts receivable separately. They must tie together, so the inventory financer may properly pre-empt the accounts receivable as collateral. But inventory financing need not be tied to the purchase of chattel paper, so it is reasonable to provide a rule which prevents the inventory financer from pre-empting the chattel paper as against a bona fide purchaser of the paper who pays for it and takes delivery.

We will now illustrate a problem of conflicting inventory liens by supposing that our retailer is a department store with an appliance department. It is theoretically possible under the Code to have a lien on a department store's total inventory. Suppose a financer intends to finance the department store's purchase of refrigerators. How does he know that he is going to get a good lien on those refrigerators as against a prior floating lien? He can, of course, check the records and learn whether there is a floating lien, and let us assume that he finds one. What can he do now? He can do one of two things. As a practical matter, he communicates with the creditor who has the prior filing which seems to cover refrigerators among other things and says, "Look, you are not financing the store's refrigerator inventory, are you? I am going to do it. Give me a letter or a subordination agreement that says that you won't claim the refrigerators as against

[53] *Ibid.*
[54] UCC § 9-308, second sentence.

me." That problem has been handled very informally in Pennsylvania and Massachusetts in that fashion and with perfect satisfaction to everybody.

To give another factual example of this problem on conflicting filing, one financial institution files a financing statement covering automobiles, but all it is handling are Chrysler cars. The dealer has an International truck franchise, and the person who is going to handle the International trucks at wholesale comes to the first financing institution and says, "Give me a letter that says that your claim to automobiles does not include any International trucks." That kind of situation, also, has been handled very easily and without difficulty.

But suppose the other financer refuses to give such a letter? Is the person who is going to finance the refrigerators or the International trucks helpless?

The answer lies in section 9-312(3), which states that a purchase-money security interest in inventory will prevail despite the general rule that the first-to-file wins, if: (1) the purchase money financer gives notice to the financer with a prior filing that he intends to do purchase-money financing; and (2) he perfects his own security interest in the refrigerators by filing before the debtor is permitted to take delivery. Now in the case of inventory that prior filing is no problem. A continuing arrangement between businessmen does not have to start before there is an opportunity for filing.

We turn now from inventory to the second stage of the retailer's problem, selling the goods at a retail and retaining a security interest. Here the problems are almost always exactly what they were pre-Code. Kentucky has a Retail Installment Sales Act but will have no problem of integrating the Code with it.

The filing, except for automobile problems to be discussed below, is simple. It is exactly the same local recording with the County Clerk that Kentucky has always had, except that no acknowledgements are needed. The places of filing are the same.

Customary forms of retail instruments can be used, but they can be substantially cut down if desired, because most of the remedies are provided by the statute and need not be provided by contract. The Code does permit a certain amount of agreement between the parties as to what is reasonable notice and a reasonable method of sale, and some draftsmanship in those areas may be useful.

Automobiles again involve the puzzling 1958 statute.[55] This statute provides that when a new lien on a motor vehicle is created, the owner must deliver the registration receipt to the chattel mortgagee; the mortgagee must take it to the clerk with the lien instrument and the proper fees for recording in accordance both with this motor vehicle registration statute and with the Code. That seems to mean that you must have double filing of your motor vehicle chattel lien.

If that is what the statute means, it renders inapplicable the provision of the Code which was designed for integration with a full certificate-of-title statute,[56] which provides in substance that if the state has a certificate-of-title law like that of Pennsylvania or Ohio, all liens are shown only on the title, and regular local filing under the Code does not apply. Since the writer doubts that Kentucky's registration receipt statute is a certificate-of-title law in this sense, it does not seem that the local filing rules of the Code are made inapplicable. Kentucky will then have double filing.

As indicated above, a creditor willing to take the risk of loss of lien when one consumer sells to another consumer need not file for refrigerators and other consumer goods except automobiles. This conforms to a practice of not filing on a calculated risk basis which has prevailed in the past in many areas.

The draftsmen of Article 9, many of whom were professors of law and felt that they were representatives of consumers against predatory financial interests, were very much worried about the banks and other financial institutions abusing the consumer. Consequently in the 1954 Code,[57] adopted in Pennsylvania, there is a provision designed to say that the consumer may always assert against the bank or other third party who purchases the chattel paper the same defenses he had against the dealer. The writer has always contended that that provision was theoretically unsound.[58] If a bank lends money to a

[55] Ky. Acts 1958, ch. 82.
[56] 1957 Official Text, § 9-302(3)(b) and (4).
[57] 1954 Official Text, § 9-206(1).
[58] Kripke, "Chattel Paper as a Negotiable Specialty under the Uniform Commercial Code," 59 Yale L. J. 1209 (1950).

consumer with which to buy a refrigerator, the bank obviously will not lose its money just because the consumer is not satisfied with the refrigerator—that is not the bank's concern. It should make no difference whether the bank gets the consumer's obligation by buying the obligation from the dealer or by lending the money to the consumer on a direct chattel mortgage. However, the Code as drafted drew a distinction: if the bank lent the money directly, it was free from these merchandise defenses, but if it bought an installment obligation from the dealer, it was subject to them. In the 1957 Official Text and in the Kentucky Code, that provision is dropped. Instead, there is a provision that in every case but consumer cases, the bank can put itself in the position of freedom from these defenses even when it buys the paper from the dealer instead of making a direct loan.[59] The statute goes on to provide, however, that if the state has a different rule for consumers, either by another statute or by judicial decision, that other rule for consumers continues to apply.

The third general problem of a retailer is the disposition of the receivables which he created in the sale of goods. These can be open accounts receivable for thirty or ninety days, which arise when a dealer sells merchandise under standard trade terms, or they can be the installment obligations secured by chattel mortgage that the Code calls "chattel paper." In both cases, the dealer has a substantial working capital problem and he may have to dispose of the receivables to obtain ready cash.

Accounts receivable financing can be handled on a sale or a loan basis. The Code applies to both types of receivables financing, because the line between them is shadowy. It can be handled on a notification or a non-notification basis so far as the purchaser is concerned, but in all cases the creditors are protected by the usual notice-filing requirement. This is the kind of continuing transaction where the notice-filing under the Code is perfectly appropriate and works very well.

In the case of chattel paper (chattel mortgages and accompanying notes) which are ordinarily sold by an automobile or refrigerator dealer and delivered to the bank or finance company, no filing is required, because the obligation is deemed to be

[59] 1957 Official Text, § 9-206.

embodied in the piece of paper in the same way as the obligation of a negotiable note is embodied in the piece of paper. Delivery perfects the assignment.[60] But there are certain kinds of transactions involving furniture or small appliance accounts where the bank or finance company does not want to collect the paper itself, does not want to notify the purchaser, and does not want to take physical delivery of the vast bulk of small retail contracts. Then filing can be used as a substitute for delivery.[61] The filing will perfect the assignment of this retail paper against everyone but a bona fide purchaser who in good faith subsequently takes delivery of the paper.[62] That is the risk of double financing. Double financing does not occur without fraud. Most people are willing to take the moral risk of fraud even when they want protection against the credit risk. But if a creditor fears the moral risk and wants to protect against double financing, he can very easily do so by marking the contracts to show the assignment. It is hard to see how any subsequent potential financer could take delivery of those contracts and claim that it acted in good faith in buying them without seeing this notice of assignment. Thus, the Code makes possible complete flexibility of technique in receivables financing.

CONCLUSION

The over-all effect of the Code's modernization of security devices is to simplify the problems of the retailer and other small debtors. The pre-existing inadequate legal structure forced the creditor to carry not only a credit risk but a legal risk, and in the long run the retailer and the public had to pay for it. When financing is simplified, its costs are reduced.

Representatives of unsecured creditors have argued that the Code is unfair in shifting the balance between secured and unsecured creditors by making secured financing too simple, but this is unsound. Unsecured creditors have no vested interest in the inadequacies of the law. No one has a right to say, "Well, maybe we can get something for ourselves as general creditors by tripping up the secured creditor and defeating his lien on

60 UCC § 9-305.
61 UCC § 9-304(1).
62 UCC § 9-308, first sentence. See also UCC § 9-309.

some technicality." That is not the way that good law to govern commercial transactions is made. If the law permits a lien to be created in any area of commerce, it is to everyone's advantage to make the securing of that lien as simple as possible. Article 9 is a great step in that direction.